acknowledged to have expertise."[204] Thus, the courts recognize that regulatory agencies generally have broad discretion to choose methods and procedures in ratemaking determinations, provided the rates are within a "zone of reasonableness."[205] By choosing to require that basic rates be "reasonable" and that upper tier rates not be "unreasonable," we believe that Congress has invoked this general body of law for application under the Cable Act. Thus, we have been instructed to consider the factors enumerated in the Cable Act and to use our expertise to achieve Congress's overall goal of ensuring "reasonable" rates for subscribers.

156. Against this legal backdrop, we have reconsidered our overall methodology for achieving the statutory goal of setting reasonable rates. While our initial regulatory methodology furthered the goal of the statute, we believe that methodology can be improved, for the reasons explained in detail herein. Upon further reflection, and based on a fuller record, we now believe that our revised methodology better achieves the overriding statutory goal of establishing reasonable rates.

157. In this regard, in response to NYNEX's petition for reconsideration, we have revisited and refined our approach to analyzing the competitive sample for purposes of estimating the competitive differential. Although we disagree with NYNEX that we can or should exclude the rates of low penetration systems from our competitive samples, we believe that our revised approach more appropriately considers the rates charged by all three categories of systems (low penetration systems, overbuilds, and municipals) that are deemed to be subject to effective competition under Section 623(l)(1) of the Act, 47 U.S.C. Section 543(l)(1).

158. In our view, our revised competitive differential of 17 percent is a more accurate reflection of the overall competitive differential, and based on a sounder methodology, than the figure of ten percent that we previously used. The difference between the two figures is primarily due to the fact that we previously averaged all of the data in our competitive sample, thus giving

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[204] United States v. FCC, 707 F.2d at 618 and cases cited therein.

[205] See Permian Basin, 390 U.S. at 800; FPC v. Natural Gas Pipeline Co., 315 U.S. 575, 586 (1942); United States v. FCC, 707 F.2d at 618.

disproportionate weight to the low penetration systems which constituted more than half of the sample, while we have now taken a more qualitative approach, under which the data regarding the three groups are considered separately. An averaging approach is less appropriate, as a technical matter, than the qualitative approach we have now adopted because the statistical tests show that the three types of systems differ from each other. Where different groups are statistically different from each other, there is no good reason to consider them as one group. It makes more sense to consider them separately, since the statistical tests tell us that they are separate groups.[206] Our refinement illustrates the sort of "pragmatic adjustment" that is within our discretion under the Cable Act of 1992 and general ratemaking principles.[207] In this manner, we more fully effectuate the statutory goal of establishing reasonable rates.

159. While we have modified the way in which the three statutory classes of systems deemed to be subject to effective competition are taken into account in arriving at the competitive differential, we have continued to consider all three categories. Our goal, as before, is to set "reasonable" rates that are no higher than the rates of systems subject to "effective competition" as defined by Congress. We believe our modified competitive differential establishes more "reasonable" rates, that is, rates approximating what would be charged if cable systems faced effective competition.

160. Our refined approach is consistent with our previous determination that "cable systems with less than 30 percent penetration should continue to be included in the sample of systems subject to effective competition."[208] While we have determined that we may not exclude from the competitive sample the rates of one of the category of systems that Congress has deemed to be subject to "effective competition," nothing in the Cable Act of 1992 requires that we estimate a competitive differential simply by averaging the per-channel rates charged by all of the systems included in our competitive sample and comparing that average to the average per-channel rate charged by the systems in our noncompetitive sample. As stated above, Congress decided not to enact the House proposal that would have required us

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[206] See supra n. 114.

[207] United States v. FCC, 707 F.2d at 618.

[208] Second R&O, at para. 128.

to establish formulas, instead providing that we "may adopt formulas or other mechanisms and procedures."[209] In addition, giving more weight to the data relating to overbuild systems -- systems that actually compete against one another to some extent -- is consistent with Congress's finding that "[w]ithout the presence of another multichannel video programming distributor, a cable system faces no local competition," and "[t]he result is undue market power for the cable operator as compared to that of consumers."[210]

161. At the same time, it is important to note that the data relating to low penetration systems affected the calculation of the competitive differential. If instead of not differing from the noncompetitive systems in our sample, the rates charged by low penetration systems had been significantly lower, we might have selected a higher competitive differential. For example, if the rates of low penetration systems in areas with many broadcast television stations had been 25 percent lower than the rates charged by noncompetitive systems, that would have suggested that the availability of over-the-air broadcast television signals limits the market power of cable systems in some circumstances. Since it is hard to see why overbuilds would have more market power than low penetration systems, a 25 percent differential would have suggested that the differential observed in our sample between overbuilds and noncompetitive systems was depressed by collusion to a greater extent than we have estimated. Accordingly, we would have revised that estimate or placed more reliance on the data involving municipal systems if the data relating to low penetration systems had been different. With respect to our authority under the statute, the point is that it is clear that the rates charged by low penetration systems were "take[n] into account," since the rates that were observed for low penetration systems affected the calculation of the competitive differential.

162. Similarly, the other factors that we have been directed to "take into account" or "consider"[211] will affect the rates charged by regulated operators. Those factors primarily involve the costs and revenues of cable companies. Because we recognize that application of the competitive

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[209] Section 623(b)(2)(B), 47 U.S.C. Section 543(b)(2)(B).

[210] That finding was set out in Section 2(a)(2) of the Cable Act of 1992, 106 Stat. 1460, which was not codified.

[211] See Sections 623(b)(2)(C) and (c)(2), 47 U.S.C. Sections 543(b)(2)(C) and (c)(2).

differential would not result in a reasonable rate for every cable system, but would instead set the rates of some systems below the amount that a cable operator without market power would charge, we are today adopting revised "cost-of-service" regulations that will permit cable operators to choose not to apply the competitive differential, but instead to have their rates set according to procedures analogous to those used to set the rates of public utilities. The optional "cost-of-service" rules that we announce today are based largely on the costs and revenues of cable companies.[212] The existence of the cost-of-service "safety valve" affects our determination of the competitive differential by allowing us to estimate it most accurately, secure in the knowledge that those operators for whom our competitive differential is inaccurate may choose not to use it.[213]

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[212] The Act requires the Commission to take into account several factors in prescribing its rate regulations for the basic and cable service tiers, many of which are cost based. The factors that the Commission is directed to take account of with respect to the basic tier include: (a) the rates charged by systems subject to effective competition; (b) the direct costs of obtaining and transmitting signals carried on the basic tier; (c) a reasonable portion of the joint and common costs of providing signals carried on the basic tier; (d) advertising revenues or other consideration obtained in connection with the basic tier; (e) a reasonable portion of franchise fees, taxes or other charges imposed on the system; and (f) amounts required to satisfy franchise-imposed public, educational, or government (PEG) or other service requirements; and (g) a "reasonable profit." See Section 623(b)(2)(C), 47 U.S.C. 543(b)(2)(C). With respect to rates for cable programming service tiers, the Act directs the Commission to consider: (a) the rates for similarly situated cable systems; (b) the rates of cable systems subject to effective competition; (c) the history of the rates for cable programming services charged by the system; (d) the rates, as a whole, of all regulated services and equipment offered by the system; (e) the capital and operating costs of the system; and (f) other revenue received by the system for carriage of the program channels included in cable programming service. See Section 623(c)(2), 47 U.S.C. 543(c)(2). In the Rate Order, we explained how our regulatory framework governing cable service rates, comprised of both the benchmark and cost-of-service approaches, is based on, and takes into account, these statutory factors. Rate Order at paras. 254, 387 n.946, 400 n.976.

[213] Petitioners for reconsideration of the April 1993 Rate Order suggest that the benchmark approach denies cable operators their constitutional right to a reasonable profit. E.g., Booth

163. Moreover, the factors involving the costs and revenues of cable companies are taken into account more directly in our calculation of the competitive differential. In determining whether a rate is "reasonable," we have focused on whether a cable operator without market power would charge such a rate. In order to stay in business over the long run, a cable operator without market power would need to charge rates that would cover, for example, its "direct costs . . . of obtaining, transmitting, and otherwise providing signals," and "the capital and operating costs of the cable system,"[214] which are among the factors we have been directed to consider in setting rates. Likewise, it is reasonable to assume that a cable operator lacking market power would charge rates that reflect, for example, "the revenues (if any) received by a cable operator from advertising."[215] The reasonable rate that is determined by applying the competitive differential should allow cable operators to cover their costs and obtain a reasonable profit. At the same time, the cost-of-service option is available for cable operators that would not be able to cover their costs after applying the competitive differential.

164. In certain respects, the approach we now adopt is analogous to the judicially approved manner in which we

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American Company et. al. Petition for Reconsideration at 10; see also Century Communications Corp. Petition for Reconsideration at 2 (benchmark, taken together with cost-of-service procedures, fails to provide for reasonable profit in violation of the Fifth Amendment); Stanley M. Searle Petition for Reconsideration at 4 (Fifth Amendment violated by a benchmark that is not cost-based for each operator); Viacom International Inc. Petition for Reconsideration at 3-4 (Hope doctrine requires full and fair recognition of external costs in going-forward methodology). We reject petitioners' constitutional argument because the courts look only at the "end result" in evaluating allegations that rates are unconstitutional. Here, the benchmark does not determine the end result because a cable system retains the option to initiate a cost-of-service proceeding if it believes that the benchmark mechanism fails to provide a reasonable return.

[214] See Communications Act, Sections 623(b)(2)(C)(ii), (c)(2)(E); 47 U.S.C. Section 543(b)(2)(C)(ii), (c)(2)(E).

[215] See Communications Act, Section 623(b)(2)(C)(iv), 47 U.S.C. Section 543(b)(2)(C)(iv) (basic tier service), and Section 623(c)(2)(F), 47 U.S.C. Section 543(c)(2)(F) (upper tier service).

prescribe a rate of return for telephone companies. In the telephone context, we select a prescribed rate of return from within a broad "zone of reasonableness" that is bounded generally on the upper end by rates that would be unreasonably high from the perspective of consumers and on the lower end by rates that would not sufficiently protect the interests of investors in the regulated enterprise. In selecting the prescribed rate of return within this broad range of permissible rates, we consider numerous factors that go into the ratemaking decision, according greater or lesser weight to individual factors on the basis of the record and in the exercise of our judgment and expertise.[216]

165. That is essentially what we have done in selecting the revised competitive differential. We have examined the rates charged by the three types of systems that Congress has determined to be subject to effective competition and determined that they charge between one percent and 37 percent less than noncompetitive systems. We have narrowed that broad range by focusing on the overbuild sample, since we have determined that the rates charged by overbuilds best approximate the "reasonable" rates that would be charged by systems lacking market power. We have adjusted the differential between overbuilds and noncompetitive systems in light of the data relating to low penetration systems and municipals, the lack of full head-to-head competition between overbuilds, and the possibility of collusion between operators in an overbuild situation. Those adjustments substantially restricted the zone from which the competitive differential was selected.

166. Our current approach is consistent with our prior legal analysis, since we did not say that all of the specifics of our prior approach were mandated by the statute. Nor could we plausibly have contended that the statute required us to calculate a competitive differential by relying on a simple averaging of the rates of all systems subject to "effective competition" as defined in the Act.[217] The only possible basis for such a conclusion would be the sentence in Section 623(b)(1) of the Communications Act, 47

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[216] See, e.g., Represcribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers, CC Docket No. 89-624, 5 FCC Rcd 7507 (1990), recon., 6 FCC Rcd 7193 (1991), aff'd sub nom. Illinois Bell Telephone Co. v. FCC, 988 F.2d 1254 (D.C. Cir. 1993); Nader v. FCC, 520 F.2d 182 (D.C. Cir. 1975).

[217] In our view, averaging the data from all systems is consistent with the terms of the statute, but is not mandated by the Cable Act.

U.S.C. Section 543(b)(1), which provides that our "regulations shall be designed to achieve the goal of protecting subscribers of any cable system that is not subject to effective competition from rates for the basic service tier that exceed the rates that would be charged for the basic service tier if such cable system were subject to effective competition." But it would not be a natural reading of that sentence, which appears to emphasize the goal of "protecting subscribers," to conclude that it requires us to calculate a competitive differential following the precise methodology that we followed previously. Besides being an unnatural reading of that sentence, such an interpretation would be inappropriate for a number of other reasons. First, as noted above, Congress made clear in Section 623(b)(2)(B), 47 U.S.C. 543(b)(2)(B), that it was not mandating the use of formulas at all. In addition, such an interpretation would negate Congress's general instruction directing us to establish "reasonable" rates. That is, there would be no point in instructing us to set "reasonable" rates if we were compelled to set rates by calculating the competitive differential exactly as we did before. Furthermore, in Section 623(b)(2)(C)(i), 47 U.S.C. Section 543(b)(2)(C)(i), Congress instructed us to "take into account . . . the rates for cable systems, if any, that are subject to effective competition." There would be no need to instruct us to take those rates "into account" if another provision compelled us to use them to set rates in a specific manner. In addition, the "if any" language in Section 623(b)(2)(C)(i) suggests that Congress was not sure that any cable systems were subject to "effective competition," and a Congress that was unsure of that fact would not have compelled us to follow the methodology that we followed previously, which is entirely dependent on the existence of such systems. Finally, it is not clear why Congress would have instructed us to take various other factors "into account" if we were obliged to follow a formula set out in another subsection of the statute.

167. In addition to adjusting the competitive differential, the other key change made with respect to rate calculations in this Order is our decision to apply the competitive differential to most cable systems although immediate rate reductions will not be required for operators with relatively low rates or for small operators while we study the prices and costs these operators experience. Nothing in the statute suggests that we were required to use a benchmark approach. Nor is our decision to defer rate reductions for some operators, pending completion of our cost study, unreasonable. To the contrary, as we have explained, nothing in the current record suggests that the competitive differential should not be applied to all

regulated operators, and economic theory suggests that cable operators with market power will exercise it. The only factor favoring an approach that limits immediate reductions is our concern that cable operators with relatively low rates may not be exercising market power to the same degree as those with higher rates. Absent cost data, we cannot determine whether that concern warrants a revision of the competitive differential for cable operators with relatively low rates. In those circumstances, the competitive differential ought to be applied to all regulated operators unless cost data convinces us otherwise.

168. Nor is our decision to delay application of the competitive differential to small operators, pending a cost study, unreasonable or contrary to the statute. As we have explained, we lack reliable data with respect to the financial situation of small operators as a class. In addition, small operators are more vulnerable than larger operators, and therefore a small operator may be harmed more seriously by application of the competitive differential if the competitive differential is not appropriate. Of course, small operators may invoke cost of service procedures -- indeed, a streamlined cost of service procedure is available for small operators -- but it would be administratively burdensome if regulators were flooded with cost of service applications from small operators. In those circumstances, it is prudent to give small operators a further opportunity to present cost data showing that they do not, as a rule, charge unreasonable rates, and to stay application of the competitive differential for small operators until that study is completed.

6. The Price Cap Governing Cable Service Rates

a. Calculation of External Costs

169. In our April 1993 Rate Order, we determined that rates for regulated cable services would be governed by a price cap once initial regulated rates were set.[218] We also determined that the price cap should be expressed as a price per channel.[219]

170. In the Rate Order, we determined that capped

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[218] See Rate Order at paras. 227, 396.

[219] Id. at para 229. We also separately provided for annual recalculations of equipment costs based on the operator's previous fiscal year or in certain cases a representative month. First Recon. Order at para. 67.

rates may be adjusted for inflation. The Commission selected an annual adjustment measured by the gross national product fixed weight price index (GNP-PI).[220] We determined that cable operators could make such inflation adjustments annually, but stated that cable operators could adjust for inflation for the part of the year between the initial date of regulation and the beginning of the next year.[221]

171. The Rate Order also provided that cable operators may pass through to subscribers increases in certain categories of external costs. Those external costs included the additional or new retransmission consent fees incurred after October 6, 1994, other programming cost increases (with some exceptions for program purchases from affiliates),[222] taxes, franchise fees,[223] and the costs of other franchise requirements including the costs of any public, educational, or governmental access programming required by the franchising authority.[224] We concluded that external cost recovery (except for franchise fees to which the annual inflation adjustment did not apply) would be permitted only to the extent that the increases exceed the

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[220] See Rate Order at para. 239. See generally 47 C.F.R. §76.922(d)(2)(i).

[221] Rate Order at para. 240. A system's initial rate included inflation from September 30, 1992 until the system's initial date of regulation or 180 days from the date of the Commission's rate regulations (i.e., by February 28, 1994), whichever occurred earlier. Id. at para. 255.

[222] Adjustments to permitted charges to reflect increases in costs of programming obtained from affiliated programmers that exceeded inflation were permitted as long as the price charged to the affiliated system reflects either prevailing company prices offered in the marketplace to third parties (where the affiliated program supplier has established such prices) or the fair market value of the programming. First Recon. Order. at para. 114. Also, increases in programming costs were required to be adjusted to reflect any revenues received by the operator from the programmer. Rate Order at para. 253, n. 602.

[223] Changes in franchise fees were not allowed to result in an adjustment to permitted charges, but were to be calculated separately as part of the maximum monthly charge per subscriber for a tier of regulated programming service. See 47 C.F.R. Section 76.922(d)(2)(v).

[224] Rate Order at paras. 241-254; see also First Recon. Order at paras. 88-115.

rate of inflation.[225] We also provided that, with the noted exception for retransmission consent fees, cable operators could pass through to subscribers any changes in external costs that accrued after the date on which the tier at issue became subject to regulation or 180 days after the effective date of our initial regulations (e.g., February 28, 1994), whichever occurred first.[226]

172. We subsequently decided that operators could file rate increases no more than quarterly on account of external cost increases.[227] We also decided that an operator must reduce its permitted rates to reflect any decreases it experiences in external costs. Such decreases must be reflected in any filings the operator makes for inflation or increases in external costs and, in any event, all decreases must be reflected in the operator's rates within one year from when they occurred.[228]

173. Thus, under our initial rules, operators may adjust their regulated rates annually by inflation and up to quarterly by the net change in external costs. As indicated above, any change in external costs must also be measured against inflation and adjusted for the corrected inflation rate. In order to simplify the calculations to be used for making these rate adjustments, however, we reconsider on our own motion our rules in this area.

174. Specifically, we have decided to separate the inflation adjustment from the external cost adjustment. Under the new approach, an operator seeking to adjust capped rates to reflect changes in its external costs will determine the actual level of its external costs. This figure will then be removed from the total charge for the affected service tier. The "residual" will be adjusted for inflation on an annual basis, but no earlier than September 30 of each year, when the final GNP-PI through June 30 of each year is released, and no later than December 31 of each

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[225] Rate Order at para. 257. In our First Order on Reconsideration, we established special rules for adjusting quarterly external cost increases for annual inflation. First Recon. Order at para. 122.

[226] Rate Order at para. 255.

[227] First Recon. Order at paras. 119-123.

[228] Id. at para. 123.

year.[229] By contrast, the external cost component that does not include the "residual" may be adjusted quarterly for net changes in external costs.[230]

175. Because the residual rate that is adjusted for inflation does not reflect the operator's external costs, there is no possibility of double recovery of external cost increases that concerned us in the Rate Order.[231] Therefore, it will no longer be necessary to compare changes in external costs to inflation, as under our initial approach, or to later adjust the external cost increases based on the annual inflation rate. The new approach will produce the same rates as the requirements specified previously in the Rate Order, but should be simpler to apply. We therefore adopt it as the method for making adjustments to capped rates for inflation and changes in external costs.

176. We will retain the requirement that, in the absence of a showing that a rate increase is necessary to avoid confiscation, operators may file rate increases no more frequently than quarterly to reflect increases in external costs, under the requirements specified in the First Recon. Order. However, to simplify the filing procedures significantly, we are requiring all systems to use calendar year quarters, rather than quarters that begin on the date the tier at issue became subject to regulation.[232] We also will allow operators to accrue external costs for any program service tier from the date on which the first of the operator's tiers became subject to regulation (or February 28, 1994, whichever was earlier).[233]

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[229] We clarify that an operator must make its inflation adjustment by the end of the calendar year if it wishes to change its rates for the changes in inflation that have occurred.

[230] As discussed above, we have also established special provisions covering adjustments to capped rates for systems eligible for transition treatment. See supra para. 130 for a fuller discussion of the transition provisions discussed in this paragraph.

[231] See Rate Order at para. 257.

[232] This change is reflected in the new forms operators are required to support their rates under the revised rules. The forms also ensure that operators are compensated for all changes in external costs that have occurred since the relevant starting date.

[233] See note 226, supra.

This will allow operators to keep track of their external costs from a single date rather than from multiple dates that may or may not be close in time to each other.[234] And, we are clarifying that operators may file for a rate increase on account of changes in external costs as soon as the information necessary to make the change is available. We believe this process best serves the interests of both subscribers and operators, without creating undue administrative burdens.[235]

177. FCC Form 1210 and associated instructions set forth the specific steps for making these calculations.

b. Copyright Fees

178. The Commission has not addressed whether copyright fees incurred by the carriage of distant broadcast signals should be accorded external cost treatment. Several petitioners request that we treat such fees as external costs, and that we allow systems to recover copyright fees from September 30, 1992, forward, separate and apart from the operators' permitted rates. In support of their request, these petitioners assert: (1) that copyright fees were not reflected in the Competitive Survey data on which

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[234] Operators that wish to adjust rates for external costs that occurred during a particular period also must include any rate adjustments needed to reflect changes that have occurred in the number of channels on regulated tiers and, if an annual change, inflation. This requirement again will greatly simplify the calculations that an operator will have to perform when adjusting rates under our price cap and going-forward methodologies.

[235] We also recognize that cable operators may experience decreases in external costs. Prompt reflection of such decreases in rates would benefit consumers. At the same time, a requirement for immediate rate filings to reflect decreases in external costs could significantly increase burdens on operators and regulators. Therefore, we do not alter our requirement that any filing to reflect increases in external costs or the annual inflation adjustment must also reflect any decreases in such costs that have occurred over the same period. We will continue to require operators to file revised rates to reflect decreases in external costs that are reflected in other rate filings no later than one year from when such decreases occur. These provisions will ensure that consumers will receive the benefits of decreases in external costs within a reasonable time without imposing significant burdens on operators. See First Recon. Order at paras. 119-123.

we based the rate formula, because many operators separately itemize these costs on subscriber bills;[236] (2) that copyright fees should be treated like taxes because they amount to a government-imposed tax on the transaction between operators and subscribers;[237] and (3) that if copyright fees are not given external cost treatment, many operators will be forced either to drop distant broadcast signals or submit cost-of-service showings.[238]

179. To the extent that petitioners are asking that we revise the rate calculation process by subtracting copyright fees from the rate survey data and then permitting a system's specific copyright fees to be added back to calculate the allowable rate for a specific system, we do not believe this change is either practical or justified. Although copyright fees may be separately itemized by some systems, there is no evidence in the record that operators did not include these itemized fees when providing information about their rates in response to our rate survey. Thus, there is no reason to assume that our survey results do not already reflect copyright fees, or that the requested change would make our survey results more accurate. Moreover, we previously determined that copyright

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[236] Intermedia Petition at 9.

[237] Id. at 8.

[238] See, generally, Intermedia Partners Petition for Reconsideration at 7-10; United Video Reply to Petitions for Reconsideration at 5. Intermedia further argues that the Commission's new mandatory signal carriage rules, 47 C.F.R. Section 76.55(c)(2), will result in operators paying additional copyright fees, which supports its assertion that copyright fees are largely beyond operators' control. Intermedia Petition at 8. We specifically addressed this question in the Rate Order regarding broadcast signal-carriage issues, noting that the 1992 Cable Act provides that a broadcaster must indemnify the cable operator for any increased copyright costs resulting from carriage of the distant broadcast signal under must-carry status. Communications Act, Section 614(b)(10)(B), 47 U.S.C. Section 534(b)(10)(B)(commercial stations); Section 615(i)(2), 47 U.S.C. Section 535(i)(2)(noncommercial and educational stations). Thus, we determined that if an operator's copyright fees increase because of new must-carry responsibilities, e.g., if the operator is required under the must-carry rules to carry a third distant signal, these incremental costs are the responsibility of the relevant broadcaster. Report and Order in MM Docket No. 92-259, 8 FCC Rcd 2965, 2992-93 (1993). The same holds true generally for noncommercial and educational stations. Id.

fees do not constitute taxes on the transaction between the operator and the subscriber because (1) they are imposed only in the sense that all legal obligations are imposed by government;[239] and (2) these fees are merely consensual arrangements relating to the consideration to be paid in exchange for carriage of programming.[240] We thus are unpersuaded by petitioners' argument that copyright fees are "taxes" that should therefore be given external cost treatment.

180. However, to the extent that petitioners' argument is that increases in compulsory copyright fees incurred by carrying distant broadcast signals should be treated in a fashion parallel to increases in the contractual costs for nonbroadcast programming, we believe it has merit. Section 76.922(d)(2) of our regulations, subject to specified limitations, permits subscriber rates to be adjusted to take into account changes in certain "external costs," including "programming costs." Copyright fee increases, whether they result from the addition of new broadcast signals to a tier, adjustments to the fee levels by the arbitration panels under the aegis of the Copyright Office, or from adjustments in tier structures, appear to fit logically within the programming costs category.

c. Pole Attachment Fees

181. The Commission has not addressed whether pole attachment fees should be accorded external cost treatment. Some cable operators argue that costs associated with pole attachment fees should be treated as external costs because (1) such fees are largely beyond their control since operators typically must utilize existing poles owned by utilities and have no choice but to pay any utility-imposed increases in pole-attachment fees, and (2) pole attachment fees historically have increased at a rate faster than inflation.[241]

182. Although pole attachment fees are to some extent beyond the control of system operators, we are not persuaded that they are sufficiently unique among the numerous categories of costs that make up the expense accounts of system operators to warrant external treatment. Unlike

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[239] Rate Order at para. 547.

[240] Id. at para. 547, n. 1402.

[241] See Crown Media Inc. Petition for Reconsideration at 4-8.

increases in franchise fees or taxes, pole attachment fees are not imposed by the government nor are they, like programming expenses, an area with respect to which the legislative history of the 1992 Cable Act expresses explicit concern.[242] In addition, some pole attachment fees are regulated under the 1978 Pole Attachment Act, 47 U.S.C. § 224, which should provide operators some recourse against unreasonable pole attachment fee increases. We accordingly will not permit operators to treat pole attachment fees as external costs.[243]

7. Other Rate Issues

183. Other rate issues raised in petitions for reconsideration are (1) whether cable operators should be allowed to charge commercial customers different rates than residential customers, (2) whether systems located in Alaska and Hawaii should be exempted from benchmark regulation, and (3) whether we should adopt a subscriber line charge that would be paid by consumers purchasing only basic service.

a. Commercial Rates

184. Cablevision and NCTA urge the Commission to clarify that cable operators are not required to charge the same rates to residential and commercial customers.[244] They contend that the ability to charge commercial rates will facilitate the provision of service to commercial subscribers, such as sports bars and restaurants, and that this benefits viewers who are customers of these commercial establishments. Cablevision also states that the 1992 Cable Act does not specifically require that the same rates be applied to commercial and residential customers. It argues that certain isolated references in the legislative history to "homes" and "households" indicate an intent that

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[242] See Rate Order at para. 8.

[243] Our rules generally provide for waivers in unusual cases. We will consider the need for special relief in instances of significant hardship resulting from unusually large pole attachment fee increases imposed by utilities or other pole providers not subject to regulation under the Pole Attachment Act. Showings of significant economic hardship in this regard may include, but will not be limited to, showings regarding both the magnitude of the increases in pole attachment fees and the impact of the increase on the operator.

[244] NCTA Petition for Reconsideration at 34; Cablevision Response To Petitions for Reconsideration at 6-8 (July 21, 1993).

residential service be regulated differently than commercial service.[245] Cablevision requests that cable operators be allowed to charge different rates to commercial subscribers, and that the determination of whether such rates are reasonable or unreasonable be made in the context of the commercial use of such cable service.[246]

185. We are not persuaded that the Commission should establish provisions authorizing special, presumably higher, rates for regulated cable services provided to commercial establishments. While it is possible that our overall standards for reasonable rates could, depending on the specific implementation, provide for special, higher rates for commercial establishments, neither the Cable Act nor its legislative history evinces an intent that the Commission should generally do so. Moreover, petitioners have not suggested how such rates would be determined. Nonetheless, it is possible that higher rates for commercial establishments could play a role in assuring that rates for subscribers are reasonable if the higher commercial earnings were offset by savings to subscribers. Accordingly, while we will not adopt regulations permitting special commercial rates at this time, we will consider, on a case-by-case basis, specific proposals that cable operators may want to make that would produce savings for consumers. In addition, we are further exploring this issue in our Further Notice of Proposed Rulemaking.[247]

b. Rate Relief for Alaska and Hawaii

186. The Medium-Sized Operators Group requests that the Commission establish special rates for cable systems located in the Alaska and Hawaii. It claims that system operating costs are significantly higher for cable systems in Alaska.[248] Alaska Cablevision urges an exemption from rate

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[245] Cablevision at 8, citing S. Rep. No. 92, 102d Cong., 1st Sess. 8 (expressing concern that "only a small percent of the cable homes" were protected by rate regulation under the Commission's 1991 definition of effective competition) and H.R. Rep. No. 628, 102d Cong., 2d Sess. 29-30 (discussing the number of "households" served by cable and its competitors).

[246] Cablevision Response to Petitions for Reconsideration at 8 (July 21, 1993).

[247] See para. 257, infra.

[248] Medium Sized Operators Group Comments on Petitions for Reconsideration at 3 (July 21, 1993).

regulation for Alaskan cable systems, particularly small systems serving rural areas.[249]

187. As discussed above, we have determined that the rates of cable systems not subject to effective competition as defined in the 1992 Cable Act presumptively reflect their market power. With certain transitional exceptions, we have required that all regulated operators reduce rates by the competitive differential in order to avoid refund liability. Petitioners have failed to present any evidence showing that rates for cable service provided by operators subject to regulation in Alaska and Hawaii do not also reflect their market power. Thus, we see no reason why operators in those states should not be subject to the same competitive differential reduction as operators in other states, or why consumers in those states should not see benefits comparable to those that will be experienced by consumers in other states.

188. Moreover, the rates charged by operators in an unregulated marketplace in Alaska and Hawaii presumptively permitted recovery of any higher costs of providing service in those states. Application of the competitive differential will reduce cable rates in those states by the same percentage as in other states. Thus, operators in Alaska and Hawaii will be able to maintain rates that reflect any relatively higher costs of providing service in those states, although reduced by the competitive differential. Furthermore, the petitioners have failed to present cost information showing that, or to what extent, the costs of providing cable service in Alaska and Hawaii are higher than in the other forty-eight states. Therefore, we are unable in any event under the present record to fashion adjustments to rates to address allegedly higher costs of providing cable service in Alaska and Hawaii. We thus reject petitioners' requests on this issue. Of course, cable operators in Alaska and Hawaii with unusually high costs may invoke the cost-of-service rules. In addition, small and low priced cable operators in Alaska and Hawaii will be eligible for transition treatment on the same terms as other cable operators in the rest of the country.[250]

c. Basic Tier Access Charge

189. Under our methodology for setting initial

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[249] Alaska Cablevision Petition for Reconsideration at 1-2, 5.

[250] See supra paras. 117-126.

regulated rates, operators develop per channel rates that are averaged across all regulated tiers, i.e., the development of rates is tier neutral. The Medium-Sized Operators Group contends that tier neutrality severely limits an operator's ability to recover the costs associated with providing the basic service tier. Petitioner claims, without support, that the cost per subscriber to provide the capital and to maintain the cable infrastructure is approximately $20 per month, excluding programming costs. Petitioner thus proposes that we adopt a "subscriber line charge" that would be paid by subscribers who purchase only the basic tier. It contends that such an approach would be consistent with policies adopted by the Commission in connection with common carriers, citing MTS & WATS Market Structure: Third Report and Order, 93 FCC 2d 241 (1983).

190. Petitioner has failed to address specifically why our requirements for setting rates for the basic and upper tiers do not adequately permit recovery of all costs of providing cable service properly allocated to regulated tiers. Petitioner has also failed to demonstrate that our approach does not permit the recovery of all costs that could be assigned to a tier under any reasonable allocation method. In addition, we note that the federally mandated subscriber line charge to which petitioner refers was established to properly allocate to telephone subscribers a portion of nontraffic sensitive fixed costs associated with local loop plant. Petitioner has not demonstrated that there are similar costs associated with the provision of basic cable service. Accordingly, we reject petitioner's assertion that operators need a special surcharge on basic service.

C. "A La Carte" Packages

191. Under the 1992 Cable Act, video programming offered on a per channel or per program ("a la carte") basis is not subject to rate regulation.[251] In the April 1993 Rate Order, we held that we would not regulate collective offerings of otherwise exempt per channel or per program services so long as: (1) the price for the combined package does not exceed the sum of the individual charges for each component of service, and (2) the cable operator continues to provide the component parts of the package to subscribers separately.[252] We stated that the second condition would be

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[251] Communications Act, Section 623(l)(2), 47 U.S.C. Section 543(l)(2).

[252] Rate Order, at paras. 326-329.

met only when the per channel offering provides subscribers with a realistic service choice.[253] We also stated that we would retain jurisdiction to review individual offerings of "a la carte" channels to determine whether the attempted offering constituted an evasion of rate regulation.[254]

192. In light of the limited type of collective offerings of per channel services that were available at the time we adopted the Rate Order, we believed it was in the public interest to allow operators to sell collective offerings of "a la carte" services without subjecting the offering to rate regulation. In particular, we believed that market forces would likely ensure that the rates for these offerings would be reasonable.[255] Allowing nonregulated treatment of collective offerings of "a la carte" channels could also serve consumers' interests by making it possible for them to purchase packages of unregulated channels at a lower price than if channels were purchased individually.

193. However, since the adoption of the Rate Order, a number of operators have restructured service offerings so that channels that could have been subject to regulation have been removed from a regulated tier and are now offered on an "a la carte" basis as well as on a package basis.[256] Since the rates of the collective offerings of the "a la

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[253] Id. at para. 328, n.808.

[254] Id.

[255] See Rate Order at para. 441, n.1105 ("Under the Cable Act, only programming sold on a per-channel or per-program basis is entirely deregulated. Thus, an operator would have to move a 'tier' channel to 'premium' status to escape regulation entirely. Based on our knowledge of industry practice to date, we doubt such changes will occur frequently....") and para. 453, n.1161 ("There is no evidence that operators would or, as a business matter, could shift programming previously offered as part of a tier to 'a la carte' status, i.e., a per-channel or per-program offering, to avoid the rate regulation applicable to tiers.").

[256] On November 17, 1993, the Mass Media Bureau issued 16 letters of inquiry to various cable operators, and on December 13, 1993, it issued another 35 letters of inquiry, most of which addressed the issue of removal and repackaging of channels. More recently, on February 22, 1994, the Cable Services Bureau issued 11 letters of inquiry to cable operators, which, among other things, asked operators to justify "a la carte" offerings that may be inconsistent with the Commission's rate regulations.

carte" channels are unregulated, operators may raise their overall rates for the same service by removing channels from regulated tiers and offering them on a package and an "a la carte" basis. We are concerned that this practice may not be consistent with the purposes of the 1992 Cable Act. In addition, we have received numerous complaints from local franchising authorities and subscribers concerning the terms and conditions of "a la carte" offerings of channels.[257] We are concerned that some of these offerings may not comply with our requirement that subscribers must have a realistic option to purchase channels that are not subject to regulation on an "a la carte" basis. Some of the repackagings of channels may also constitute prohibited evasions of rate regulation.[258]

194. As stated in the Rate Order, providing for nonregulated treatment of collective offerings of "a la carte" channels affords operators an opportunity to enhance consumer choice by making programming more affordable and more widely available.[259] At the same time, however, permitting nonregulated treatment can provide an opportunity for operators to engage in evasion of rate regulation.[260] On reconsideration, therefore, we continue to believe that the public interest will be served by generally permitting

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[257] See FCC News, "FCC Issues Letters of Inquiry Concerning Cable Rate Restructuring" (Nov. 17, 1993); FCC News, "FCC Sends 35 Letters of Inquiry Concerning Cable Rate Complaints" (Dec. 13, 1993); FCC News, "FCC Sends 11 Letters of Inquiry Concerning Cable Rate Complaints" (Feb. 23, 1994).

[258] Section 623(h) of the 1992 Cable Act, 47 U.S.C. Section 543(h), requires the Commission to establish standards, guidelines, and procedures to prevent evasions, including evasions that result from retiering, of rate regulation. The Commission defined a prohibited evasion as any practice or action which avoids our rules contrary to the intent of the Act or its underlying policies. See Rate Order at para. 451.

[259] Rate Order at para. 327.

[260] Service offerings that evade rate regulation will not be eligible for nonregulated treatment. If an operator seeks to establish nonregulated collective offerings of "a la carte" channels in a manner that evades rate regulation, the minimum remedy will be that the collective offering will be treated as a regulated tier of cable service, and that all of the operator's calculations of its permitted rates for regulated service must be adjusted accordingly. Forfeitures may also be appropriate in some cases.

nonregulated treatment of collective offerings of "a la carte" channels if the offering enhances consumer choice and does not constitute an evasion of rate regulation. We believe that these objectives will be achieved if operators comply with the safeguards of our initial rules. Thus, collective offerings of otherwise exempt per channel or per program services will continue to be unregulated as long as: (1) the price for the combined package does not exceed the sum of the individual charges for each component of service, and (2) the cable operator continues to provide the component parts of the package to subscribers separately. This latter safeguard will be met if the "a la carte" offering constitutes a realistic service choice.

195. However, in order to address our concerns that some offerings established by operators in response to rate regulation may not be consistent with our goals and the 1992 Cable Act, and the fact that other offerings that could raise similar concerns could be initiated in the future, we are here providing interpretive guidelines for determining whether an operator's collective offering of "a la carte" channels should be accorded regulated or unregulated treatment.[261] These guidelines will enable operators to better determine what collective offerings of "a la carte" channels will be considered an evasion of rate regulation and/or a realistic service offering, and will help local authorities[262] and the Commission to assess expeditiously the appropriate regulatory status of individual offerings.[263] In

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[261] We note that parties have raised a number of questions regarding how we define multiplexed services. We will decide that issue in a separate proceeding.

[262] As we explain below, local authorities may make determinations as to whether a collective offering of "a la carte" channels should be considered a regulated tier, even if the tier would be a cable programming services tier, because both our rules for setting initial regulated rates and our methodology for adjusting capped rates on a going-forward basis are based on the total number of channels on all regulated tiers. Thus, local authorities will need to determine whether a collective offering of "a la carte" channels is a regulated tier in order to determine the correct permitted rate for the basic service tier.

[263] Packages of "a la carte" channels offered prior to April 1, 1993, the date we adopted the Rate Order, will be accorded nonregulated treatment. This limited "grandfathering" of packages available on April 1, 1993 will avoid elimination of discounts that were available to consumers at that time and that may continue to be available.

evaluating offerings in individual cases, we will consider whether consumers are being offered a greater variety of programming choices and options and whether the price for those choices is generally increasing or decreasing from previous levels.[264]

196. We have identified several factors that local authorities and the Commission should consider in assessing in an individual case whether an "a la carte" package enhances consumer choice and does not constitute an evasion of rate regulation. Several of these factors, if present, would suggest that the rates for the offering should be unregulated. These are:

(1) the operator had offered (or begun to explore offering) "a la carte" packages consisting of non-premium channels prior to rate regulation;

(2) the operator has conducted market research that suggests introducing an "a la carte" package" would be profitable, other than as a means of evading rate regulation;

(3) the subscriber is free to select which channels will be included in the package;

(4) subscribers are given notice that fully discloses their options, as well as fully discloses the total price (including related equipment charges) associated with exercising any of these options; and

(5) an insignificant percentage or number of channels in the package has been removed from regulated tiers.[265]

On the other hand, the following factors would weigh against allowing unregulated treatment of collective offerings of "a

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[264] Thus, for example, if the total number of channels available to subscribers, including channels in the "a la carte" package, increases and the price for all offerings, including the package, remains the same, the Commission will be less likely to consider the package an evasion of rate regulation, provided that factors that would militate against nonregulated treatment, such as removal of channels from regulated tiers, are not significantly present.

[265] What percentage is "insignificant" will be determined by the Commission on a case-by-case basis.

la carte" channels:

(1) the introduction of the "a la carte" package results in avoiding rate reductions that otherwise would have been required under the Commission's rules;

(2) a significant percentage[266] or number of channels in the package were removed from regulated tiers;[267]

(3) the package price is so deeply discounted when compared to the price of an individual channel or the sum of the prices of the individual channels that it does not constitute a realistic set of service choice because subscribers will not have any realistic options other than subscribing to the package;[268]

(4) the channels taken from regulated tiers have not traditionally been marketed "a la carte";

(5) an entire regulated tier has been eliminated and turned into an "a la carte" package;

(6) the subscriber must pay a significant equipment charge to purchase an individual channel in the package;

(7) the subscriber must pay a "downgrade charge" (an additional charge) to purchase an individual channel in the package;

(8) the "a la carte" package includes channels that were removed from lower tiers of channels, so that subscribers to those lower tiers are required to buy one or more intermediate tiers in order to receive the same channels;

(9) subscribers are automatically subscribed to the "a

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[266] See supra note 264.

[267] In assessing this factor, regulators may consider whether including some previously regulated channels may be necessary for the successful marketing of the new package.

[268] For purposes of determining whether packages are deeply discounted, we may look at the industry's traditional discounting practices.

la carte" package through, for example, such means as negative option billing; and

(10) the affected programmers object to the restructuring of their services into "a la carte" packages.

No single factor will necessarily be dispositive in any case. Rather, we will assess the totality of the circumstances, analyze whether one or more of the foregoing factors is present, and determine whether the offering intentionally, or in effect, constitutes an evasion of rate regulation.

197. Under our requirements for setting initial regulated rates, the rate for a regulated program service tier will be determined in part by the system's total revenues for all regulated tiers and the total number of regulated channels it offers.[269] Similarly, our methodology for adjusting capped rates for adding or deleting channels from a regulated tier is determined in part by the total number of regulated channels.[270] Thus, local authorities will need to determine the total number of regulated channels offered by the operator in order to properly set rates for the basic service tier. This will require a determination of whether any collective offerings of "a la carte" channels should be considered a regulated tier. Accordingly, we will permit local authorities to make initial determinations as to whether a collective offering of "a la carte" channels should be considered a regulated tier, even if the collective offering would be a cable programming service tier if it were regulated.[271]

198. Under the requirements that we are adopting, local authorities may, at their option, make an initial

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[269] See supra paras. 78, 82.

[270] We establish and explain our "going-forward" methodology for adjusting capped rates for the addition and deletion of channels from regulated tiers in the Fourth Report and Order, infra, at paras. 245-249.

[271] FCC Form 1215 requires that operators fully describe any collective offerings of "a la carte" channels offered in the franchise area. FCC Form 1215 must also be filed along with each Form 1200 setting initial rates and Form 1210 updating rates. Local authorities and the Commission, therefore, will be able to determine in individual rate cases whether any "a la carte" packages are relevant to necessary rate determinations.

decision addressing only the regulatory status of any "a la carte" package at issue. The franchising authority must make this initial decision within the 30 day period for reviewing basic cable rates and equipment costs, or within the first 60 days of an extended 120 day period (if the franchising authority has requested an additional 90 days).[272] The franchising authority shall provide public notice of its initial decision within seven days pursuant to local procedural rules for public notice. Operators or consumers may make an interlocutory appeal of this initial decision to the Commission within 14 days of the initial decision.[273] (Within 14 days of the initial ruling, an operator shall provide notice to the franchising authority whether it will, or will not, make such an appeal.) The Commission will rule expeditiously on these appeals, and the local authority may then proceed with its local rate case in light of the Commission's decision on the interlocutory appeal.

199. Alternatively, local authorities may make any necessary "a la carte" determination as part of their final decision setting rates for the basic service tier. That decision may then be appealed to the Commission as provided under current rules concerning appeals of local decisions to the Commission. In any appeal of a local decision, the Commission will defer to the local authority's findings of fact if there is a reasonable basis for the local findings. The Commission will then apply FCC rules and precedent to those facts to determine the appropriate regulatory status

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[272] See 47 C.F.R. Section 76.933(a);(b)(1).

[273] This limited initial decision will toll time the periods under Section 76.933 of our rules within which local authorities must decide local rate cases. The time period will then begin running again seven days after the Commission rules on the interlocutory appeal, or seven days following the expiration of the period in which an interlocutory appeal may be filed. For example, if a cable operator offering a package of "a la carte" channels makes its rate filing on May 15, 1994 and the franchising authority makes an initial decision regarding the regulatory status of the package on June 1, 1994 (and provides required notices to the operator and subscribers), the remainder of the 30-day period (required under 47 C.F.R. Section 76.933) is tolled until either June 22, 1994 (14 days to appeal plus seven day grace period) -- if no appeal is filed, or until seven days after a Commission ruling on the interlocutory appeal. Thus, if the Commission were to decide the matter on August 1, 1994, the 30-day period in which franchising authorities must review rate filings would resume running on August 8, 1994.